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RUEHIL/AMEMBASSY ISLAMABAD 3265
RHEBAAA/DEPT OF ENERGY WASHDC
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DEPT PASS TO USTR DHARTWICK/CLILIENFELD/AADLER
DEPT PASS TO TREASURY FOR OFFICE OF SOUTH ASIA ABAUKOL
TREASURY PASS TO FRB SAN FRANCISCO/TERESA CURRAN
STATE FOR SCA/INS MICHAEL NEWBILL AND EB/TRA JEFFREY HORWITZ AND TOM ENGLE
PASS TO FAA THOMAS NASKOVIAK
PASS TO DOT DAVID MODESSIT

E.O. 12958: N/A
TAGS: EAGR EFIN EINV ETRD IN
SUBJECT: NEW DELHI WEEKLY ECON OFFICE HIGHLIGHTS

¶1. (U) Below is a compilation of Economic highlights from Embassy New Delhi for the week of May 21-25, 2007.

REF: NEW DELHI 02347

CREDIT DEFAULT SWAPS TO
DEEPEN DEBT MARKET

¶2. (U) On May 16, the Reserve Bank of India (RBI) issued draft guidelines for the introduction of the much-awaited credit default swaps (CDS) that it has been planning since 2003. The availability of CDS would enable banks to manage their credit risks better, A CDS is a simple form of credit derivative that allows banks to insure or hedge the underlying debt asset by buying protection and transferring the risk of credit default to the investor (the seller of the protection). RBI has decided to initially allow only simple CDS's restricted to single-entity credit transactions for rupee-denominated loans in the domestic market. The introduction of CDS is a follow up to RBI's April 24 credit policy that promised a "gradual process of financial sector liberalization" in India. According to RBI's website, RBI considers it appropriate now to introduce more financial derivative products because the risk management architecture of Indian banks has strengthened and banks are becoming Basel II compliant. Also, a recent amendment to the RBI Act, 1934 provides legality to over-the-counter derivative instruments, including credit derivatives.

¶3. (U) C.E.S. Azariah, CEO of Fixed Income Money Markets and Derivatives Association (FIMMDA) explained to Congen that existing RBI-defined single-entity credit exposure limits to business groups, constrain banks from growing their credit exposures to the corporate sector. CDS, Azariah explained, allows banks to reduce their existing exposures to a single-entity by buying credit protection for part of the underlying loan, freeing the bank to then lend more to the same business group. He said that as the CDS market matured and developed ratings, banks would be able to take increased exposure to less-than triple A rated corporations. Banks and

financial sources in Mumbai have welcomed RBI's belated step to introduce credit derivatives. They see this as the first step towards triggering trading in corporate bonds. Also, they expect this to be a forerunner to developing India's debt market as a source for infrastructure financing. These assets are considered long and risky exposures for banks that would need protection against credit default.

¶4. (U) V. Srinivasan, Treasury Head of J.P. Morgan, said that the RBI-proposed CDS is a small though positive step towards liberalization. American financial companies such as J.P. Morgan and Merrill Lynch are working with FIMMDA and Primary Dealers' Association to persuade RBI to allow CDS's to be traded as is done in overseas markets. Cash-deficit foreign banks would be more interested in writing protection and trading in Indian corporate debt, they noted. S.P. Prabhu of IDBI Capital said that a domestic restriction when the corporate sector is growing rapidly is resulting in exporting India's financial markets overseas, contrary to the objective of making Mumbai an international finance center. Our financial sources informed us that Hong Kong and Singapore have emerged as the hub for credit derivatives, in the absence of Indian market permission. According to Jayesh Mehta, Managing Director and Head of Debt Markets, DSP Merrill Lynch, with Indian companies borrowing overseas or issuing foreign currency convertible bonds (FCCBs), credit derivatives of Indian corporations are being transacted overseas. Comment: As discussed reftel, there is growing interest in rupee-denominated products that RBI restrictions have forced offshore. Allowing CDS's is an important step towards a more liberal and deeper financial sector, and a step that directly encourages much-needed long-term debt products to finance corporate expansion and infrastructure. End comment.

¶5. (U) Visit New Delhi's Classified Website:
http://www.state.sgov/p/sa/newdelhi

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